UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 8-K/A

CURRENT REPORT
PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

Date of Report (Date of earliest event reported): **December 15, 2010**

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	**0-27231**	**13-3818604**
(State or other jurisdiction of incorporation)	Commission file number	(I.R.S. Employer identification number)

4820 Eastgate Mall, San Diego, CA 92121
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(858) 812-7300**

N/A
(Former name, or Former Address, if Changed Since Last Report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 2.01 Completion of Acquisition or Disposition of Assets.

This Current Report on Form 8-K/A amends the Current Report on Form 8-K filed with the Securities and Exchange Commission on December 16, 2010 by Kratos Defense & Security Solutions, Inc., a Delaware corporation (the "Company"), to provide the required financial statements and exhibits in connection with the Company's acquisition, through a wholly-owned subsidiary, of Henry Bros. Electronics, Inc. a Delaware Corporation ("HBE"), for $56.6 million of which $54.9 million was paid in cash and $1.7 million reflects the fair value of the replacement options issued to HBE option holders.

Item 9.01 Financial Statements and Exhibits.

(a) Financial statements of businesses acquired.

(i) Audited consolidated financial statements of Henry Bros. Electronics, Inc. and Subsidiaries as of December 31, 2009 and 2008 and for each of the three years in the period ended December 31, 2009 and related notes to the consolidated financial statements are attached hereto as Exhibit 99.1.

(ii) Unaudited condensed consolidated financial statements of Henry Bros. Electronics, Inc. and Subsidiaries as of September 30, 2010 and December 31, 2009, and for the nine months ended September 30, 2010 and 2009 and related notes to the condensed consolidated financial statements are attached hereto as Exhibit 99.2.

(b) Pro forma financial information.

(i) Unaudited pro forma condensed combined financial statements as of and for the nine months ended September 26, 2010 and for the year ended December 27, 2009, are attached hereto as Exhibit 99.3.

(d) Exhibits.

Exhibit No.	Description
23.1	Consent of Independent Registered Public Accounting Firm – Amper, Politziner & Mattia LLP
99.1	Audited consolidated financial statements of Henry Bros. Electronics, Inc. and Subsidiaries as of December 31, 2009 and 2008 and for each of the three years in the period ended December 31, 2009 and related notes to the consolidated financial statements.
99.2	Unaudited condensed consolidated financial statements of Henry Bros. Electronics, Inc. and Subsidiaries as of September 30, 2010 and December 31, 2009, and for the nine months ended September 30, 2010 and 2009 and related notes to the condensed consolidated financial statements.
99.3	Unaudited pro forma condensed combined financial statements as of and for the nine months ended September 26, 2010 and for the year ended December 27, 2009.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

Date: February 4, 2011

By: /S/ Deanna H. Lund
Deanna H. Lund
Executive Vice President, Chief Financial Officer

Exhibit Index

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99.3	Unaudited pro forma condensed combined financial information as of and for the nine months ended September 26, 2010 and for the year ended December 27, 2009.

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the inclusion in this Current Report on Form 8-K/A of Kratos Defense & Security Solutions, Inc. of our report dated March 12, 2010 on the financial statements of Henry Bros. Electronics, Inc. and Subsidiaries as of December 31, 2009 and 2008 and for each of the three years in the period ended December 31, 2009. We also consent to the incorporation by reference of said report in the Registration Statements of Kratos Defense & Security Solutions, Inc. on Form S-3 (File No. 333-161340) and on Forms S-8 (File No. 333-90455, File No. 333-54818, File No. 333-71702, File No. 333-91852, File No. 333-116903, File No. 333-124957, File No. 333-127060, File No. 333-155317 and File No. 333-157826).

/s/ Amper, Politziner & Mattia LLP

February 3, 2011
Edison, New Jersey

Exhibit 99.1

Consolidated Financial Statements and Report of
Independent Certified Public Accountants

HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES

December 31, 2009 and 2008

HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Henry Bros. Electronics, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Henry Bros. Electronics, Inc. and Subsidiaries (the "Company") as of December 31, 2009 and 2008, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting pri nciples used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Henry Bros. Electronics, Inc. and Subsidiaries as of December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Amper, Politziner & Mattia LLP

March 12, 2010
Edison, New Jersey

HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31, 2009	December 31, 2008
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 2,917,046	$ 27,704
Accounts receivable-net of allowance for doubtful accounts of $712,206 at December 31, 2009 and $801,306 at December 31, 2008	12,053,139	18,164,066
Inventory	1,245,306	1,201,477
Costs in excess of billings and estimated profits	6,003,533	5,512,101
Deferred tax asset	1,251,443	1,363,309
Retainage receivable	295,928	1,756,481
Prepaid expenses and income tax receivable	1,423,541	878,003

	2009	2008
Other assets	161,479	330,052
Total current assets	25,351,415	29,233,193
Property and equipment - net of accumulated depreciation of $3,622,058 at December 31, 2009 and $2,993,961 at December 31, 2008	2,254,054	2,328,438
Goodwill	3,785,480	3,592,080
Intangible assets - net of accumulated amortization $ 1,187,013 in 2009 and $1,018,870 in 2008	888,752	1,016,665
Deferred tax asset	—	—
Other assets	412,594	439,732
TOTAL ASSETS	$ 32,692,295	$ 36,610,108
LIABILITIES & STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 5,360,471	$ 6,927,365
Accrued expenses	3,507,060	4,833,618
Accrued taxes	—	200,774
Billings in excess of costs and estimated profits	1,567,874	2,006,751
Deferred income	136,574	157,890
Current portion of long-term debt	536,552	629,742
Other current liabilities	494,017	532,932
Total current liabilities	11,602,548	15,289,072
Long-term debt, less current portion	4,830,517	4,855,662
Deferred tax liability	318,850	406,417
TOTAL LIABILITIES	16,751,915	20,551,151
STOCKHOLDERS' EQUITY		
Preferred stock, $.01 par value; 2,000,000 shares authorized; no shares issued	—	—
Common stock, $.01 par value; 20,000,000 shares authorized at December 31, 2009 and 10,000,000 shares authorized at December 31, 2008. 6,035,366 shares issued and outstanding in 2009 and 5,966,583 shares in 2008	60,354	59,666
Additional paid in capital	18,437,288	17,732,596
Accumulated deficit	(2,557,262)	(1,733,305)
TOTAL EQUITY	15,940,380	16,058,957
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$ 32,692,295	$ 36,610,108

See accompanying notes to the consolidated financial statements.

HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the years ended December 31,		
	2009	2008	2007
Revenue	$ 55,105,469	$ 62,357,466	$ 57,852,216
Cost of revenue	40,848,553	46,465,194	45,076,126
Gross profit	14,256,916	15,892,272	12,776,090
Operating expenses:			
Selling, general & administrative expenses	14,985,849	12,797,730	12,695,509
Intangible asset impairment charges	—	—	43,999
Operating (loss) profit	(728,933)	3,094,542	36,582
Interest income	28,610	91,558	73,493
Other income	38,885	17,266	(191)
Interest expense	(280,911)	(271,290)	(349,907)
(Loss) income before tax expense	(942,349)	2,932,076	(240,023)
Tax (benefit) expense	(118,392)	1,374,320	63,281
Net (loss) income	$ (823,957)	$ 1,557,756	$ (303,304)
BASIC (LOSS) EARNINGS PER COMMON SHARE:			
Basic (loss) earnings per common share	$ (0.14)	$ 0.27	$ (0.05)
Weighted average common shares	5,865,187	5,786,104	5,768,864
DILUTED (LOSS) EARNINGS PER COMMON SHARE:			
Diluted (loss) earnings per common share	$ (0.14)	$ 0.26	$ (0.05)
Weighted average diluted common shares	5,865,187	5,988,782	5,768,864

See accompanying notes to the consolidated financial statements.

HENRY BROS. ELECTRONCS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock par value $0.01 Shares	Common Stock par value $0.01 Amount	Additional Paid-in Capital	Retained Earnings	Total
Balance at December 31, 2006	5,916,065	$ 59,161	$ 16,900,653	$ (2,949,196)	$ 14,010,618
Cumualitive effect for adpotion of ASC 740				(38,561)	(38,561)
Shares issued in connection with the acquisition of CIS Security Systems	10,000	100	37,400		37,500
Amortization of value assigned to stock option grants			227,839		227,839
Net loss				(303,304)	(303,304)
Balance at December 31, 2007	5,926,065	59,261	17,165,892	(3,291,061)	13,934,092
Recovery from shareholder, net			59,443		59,443
Surrendered shares to purchase fixed asset	(3,200)	(32)	(14,048)		(14,080)
Employee stock options exercised	23,718	237	119,021		119,258
Shares issued in connection with the acquisition of CIS Security Systems	20,000	200	120,350		120,550
Amortization of value assigned to stock option grants			281,938		281,938
Net income				1,557,756	1,557,756
Balance at December 31, 2008	5,966,583	59,666	17,732,596	(1,733,305)	16,058,957
Employee stock options exercised	43,783	438	203,231		203,669
Shares issued in connection with the acquisition of CIS Security Systems	25,000	250	139,100		139,350
Amortization of value assigned to stock option grants			362,361		362,361
Net loss				(823,957)	(823,957)
Balance at December 31, 2009	6,035,366	$ 60,354	$ 18,437,288	$ (2,557,262)	$ 15,940,380

See accompanying notes to the consolidated financial statements.

HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the years ended December 31, 2009	2008	2007
Cash flows from operating activities:			
Net (loss) income	$ (823,957)	$ 1,557,756	$ (303,304)
Adjustments to reconcile net income from operations to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,040,322	840,738	899,325
Bad debt expense	316,181	346,602	41,123
Provision for obsolete inventory	8,305	202,490	180,000
Impairment charges	—	—	43,999
Stock option expense	362,361	281,938	227,839
Deferred income taxes	24,299	88,895	(26,730)
Changes in operating assets and liabilities:			
Accounts receivable	5,794,746	(5,204,110)	280,677
Inventory	(43,830)	56,964	67,002
Costs in excess of billings and estimated profits	(491,432)	(2,317,062)	1,448,430
Retainage receivable	1,460,554	(48,357)	(317,657)
Other assets	195,711	(14,970)	(25,002)
Prepaid expenses and income tax receivable	(545,537)	22,920	(446,123)
Accounts payable	(1,566,894)	(1,230,408)	2,184,728
Accrued expenses	(1,326,558)	1,766,022	(1,576,749)

Taxes Payable	(200,774)	—	—
Billings in excess of costs and estimated profits	(438,877)	429,749	409,743
Deferred income	(21,317)	(48,571)	(270,315)
Other liabilities	(38,915)	81,437	198,609
Net cash provided by (used in) operating activities	3,704,388	(3,187,967)	3,015,595
Cash flows from investing activities:			
Purchase of businesses, net of cash acquired	(90,230)	(62,500)	(25,000)
Purchase of property and equipment	(429,688)	(569,494)	(652,704)
Net cash used in investing activities	(519,918)	(631,994)	(677,704)
Cash flows from financing activities:			
Recovery from shareholder, net	—	59,443	—
Proceeds from exercising of stock options - net of fees	203,669	119,258	—
Borrowings under revolving loan agreement	2,150,000	700,001	788,000
Repayments under revolving agreement	(2,150,000)	—	—
Payments of bank loans	(103,410)	(221,110)	(206,602)
Net repayments of other debt	(74,328)	—	(9,135)
Payments of equipment financing	(321,059)	(87,377)	167,443
Net cash used in financing activities	(295,128)	570,215	739,706
Increase (decrease) in cash and cash equivalents	2,889,342	(3,249,746)	3,077,597
Cash and cash equivalents - beginning of period	27,704	3,277,450	199,853
Cash and cash equivalents - end of period	$ 2,917,046	$ 27,704	$ 3,277,450
Supplemental disclosure of cash flow information:			
Amount paid for the period for:			
Interest	$ 276,553	$ 265,876	$ 331,924
Taxes	707,083	1,032,642	240,000
Non-cash investing and financing activities:			
Equipment financed	368,108	316,511	359,040
Issuance of stock to acquire businesses	143,400	120,550	37,500
Surrender shares to purchase fixed assets	—	14,080	—

See accompanying notes to the consolidated financial statements.

HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Henry Bros. Electronics, Inc., (the "Company") and its subsidiaries, are divided into two business segments — Security System Integration ("Integration") and Specialty Products and Services ("Specialty"). The Integration segment provides "cradle to grave" services for a wide variety of security, communications and control systems. The Company specializes in turn-key systems that integrate many different technologies. Systems are customized to meet the specific needs of its customers. Through the Specialty Products and Services segment we provide emergency preparedness programs, mobile digital recording solutions and specialized radio frequency communication equipment and integration. Each of the Company's segments markets nationwide with an emphasis in the Arizona, California, Colorado, Maryland, New Jersey, New York, Texas and Virginia me tropolitan areas. Customers are primarily medium and large businesses and governmental agencies. The Company derives a majority of its revenues from project installations and to a smaller extent, maintenance service revenue.

The table below shows revenue percentage by geographic location for each of the years ended December 31:

	Year ended December 31, 2009	2008	2007
New Jersey/New York	51%	45%	46%
California	17%	20%	20%
Texas	5%	4%	4%
Arizona	8%	11%	8%
Colorado	10%	8%	9%
Virginia / Maryland	8%	10%	8%
Integration segment	99%	98%	95%
Specialty segment	4%	2%	7%
Inter-segment	-3%	0%	-2%
Total revenue	100%	100%	100%

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Acquisitions are recorded as of the purchase date, and are included in the consolidated financial statements from the date of acquisition. All material intercompany transactions have been eliminated in consolidation.

(b) Revenue Recognition

Revenue from a project in either the Integration or Specialty segments are recognized on the percentage of completion method, whereby revenue and the related gross profit are determined based upon the actual costs incurred to date for the project to the total estimated project costs at completion. Project costs generally include all material and shipping costs, the Company's direct labor, subcontractor costs and an allocation of indirect costs related to the direct labor. Changes in the project scope, site conditions, staff performance and delays or problems with the equipment used on the project can result in increased costs that may not be billable or accepted by the customer and results in a loss or lower profit from what was originally anticipated at the time of the proposal.

Estimates for the costs to complete the project are periodically updated by management during the performance of the project. Provision for changes in estimated costs and losses, if any, on uncompleted projects are made in the period in which such losses are determined. In general, we determine a project to be substantially completed after:

1. The scope of work is completed which includes installing the equipment as required in the contract.

2. System is functional and has been tested.

3. Training has been provided.

Except for projects in excess of $1 million, the majority of the Company's projects are completed within a year. Revenue from product sales are recognized when title and risk of loss passes to the customer. Service contracts, which are separate and distinct agreements from project agreements, are billed either monthly or quarterly. Accordingly, revenues from service contracts are recognized ratably over the length of the agreement.

(d) Use of Estimates

The preparation of financial statements, in conformity with generally accepted accounting principles in the United States, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities, at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue and costs relating to security integration systems projects and service agreements are particularly affected by management's estimates. The contract sale price and estimated costs are based upon the facts and circumstances known at the time of the proposal. Estimates for the costs to complete the contract are periodically updated during the performance of the contract. Unpredictable events can occur during the performance of the contract that can increase the costs and reduce the estimated gross profit. Change orders to record additional costs may not be approved or can become subject to long negotiations with the customer and can result in concessions by the Company. Considerable judgments are made during the performance of the contract that affects the Company's revenue recognition and cost accruals that may have a significant impact on the results of operations reported by the Company.

(e) Cash Equivalents

The Company considers highly liquid instruments with original maturity of three months or less to be cash equivalents.

(f) Trade Receivables and Allowance for Doubtful Accounts

Trade receivables are stated at net realizable value. This value includes an appropriate allowance for estimated uncollectible accounts. The allowance is evaluated on a regular basis by management and is based upon historical experience with the customer, the aging of the past due amounts and the relationship with and economic status of our customers. The evaluation is based upon estimates taking into account the facts and circumstances at the time of the evaluation. Actual uncollectible accounts could exceed the Company's estimates and changes to its estimates will be accounted for in the period of change. Account balances are charged against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

(g) Inventory

Inventory is stated at the lower of cost or market value. Cost has been determined using the first-in, first-out method. Inventory quantities on-hand are periodically reviewed, and where necessary, reserves for excess and obsolete inventories are recorded.

(h) Retainage Receivable

Retainage receivables represent balances billed but not paid pursuant to retainage provisions of the project contracts and will be due and payable upon completion of specific tasks or the completion of the contract.

(i) Property and Equipment

Property and equipment are recorded at cost, net of accumulated depreciation. Depreciation is computed on a straight-line basis over estimated useful lives of four to ten years. Leasehold improvements are amortized over the shorter of related lease term or the estimated useful lives. Upon retirement or sale, the costs of the assets disposed of and the related accumulated depreciation are removed from the accounts and any resulting gain or loss is included in the determination of income. Repairs and maintenance costs are expensed as incurred. Annually, the Company routinely reviews its property and equipment for impairment, and accordingly, will write-down those assets to their estimated fair value. There was no impaired property and equipment in 2009, 2008 and 2007.

(j) Intangible Assets

The Company's intangible assets include goodwill and other intangibles. Other intangibles consist of the fair value of acquired customer lists, service contracts acquired, trade names, and covenants not to compete. Goodwill represents the excess of purchase price over fair value of net assets acquired at the date of acquisition. Collectively, these assets which affect the amount of future period amortization expense and possible impairment expense that we will incur. Management's judgments regarding the existence of impairment indicators are based on various factors, including market conditions and operational performance of our business. As of December 31, 2009 and 2008, we had $4,674,232 and $4,608,745, respectively, of goodwill and other intangibles, accounting for 14.3% and 12.6% of our total assets at the respective dates. The goodwill is not amortizable; the majority of other intangib les are. The determination of the value of such intangible assets requires management to make estimates and assumptions that affect our consolidated financial statements. We test our goodwill for impairment, at least annually. This test is conducted in December of each year in connection with the annual budgeting and forecast process. Also, on a quarterly basis, we evaluate whether events have occurred that would negatively impact the realizable value of our intangibles or goodwill.

Effective January 1, 2002, the Company adopted the provisions of FASB ASC 350 "Goodwill and Other". In accordance with that statement, goodwill and intangible assets with indefinite lives are not amortized, but are tested at least annually for impairment. Prior to January 1, 2002, the Company had not recorded goodwill or other intangible assets of indefinite lives. Intangible assets with estimable useful lives, consisting primarily of acquired customer lists, service contracts and covenants not to compete are amortized on a straight-line basis over their estimated useful lives of three to fifteen years and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. If the intangible asset's remaining useful life is changed, the intangible asset will be amortized over the remaining useful life. If the asset being amortized is determined to have an indefinite useful life, the asset will be tested for impairment. The impairment test will consist of measuring its fair value with its carrying amount. If the carrying amount of the intangible assets exceeds its fair value, an impairment loss is recognized for an amount equal to the excess and the adjusted carrying amount is recognized as its new accounting basis.

The Company's goodwill impairment test is based on a two part procedure consistent with the requirements of FASB ASC 350. The first test consists of determining the fair value of the reporting unit and comparing it to the carrying value of the reporting unit. If the carrying value of the reporting unit exceeds the fair value of the reporting unit, a second test is performed. In step two, the implied fair value of the goodwill (which is the excess of the fair value of the reporting unit over the fair value of the net assets) is compared to the carrying value of the goodwill. An impairment loss is recognized for any excess value of goodwill over the implied value. We determined the reporting unit by analyzing geographic regions, as management evaluates the Company's performance in this manner. We have identified five separate and distinct operating units for the testing requirements of FASB ASC 350, and evaluate each reporting unit for impairment.

We completed our annual goodwill impairment analysis as of December 31, 2009. Our assessment did not result in good will impairment. Significant assumptions used in the include revenue growth, margins and discount rates. We used historical performance and management estimates of future performance to determine margins and growth rates. Of reporting units with goodwill, these entities had a combined fair value that is in excess of its carrying value by approximately 147%. However, there were certain individual entities that, while not requiring an impairment expense in 2009, given the current economic climate, resulted in a reduction in the fair value that is in excess of its carrying value compared to the impairment analysis conducted in 2008. Considerable management judgment is necessary to evaluate the impact of operating changes and to estimate future cash flows. Changes in our actual results and/ or estimates or any of our other assumptions used in our analysis could result in a different conclusion.

The Company recorded an impairment charge of $43,999 for the write down of a trade name for the year ended December 31, 2007. There were no write downs for the years ended December 31, 2009 and 2008.

In 2009, 2008 and 2007 there no charges to operations resulted from management's goodwill impairment evaluation.

(k) Concentrations of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents and accounts receivable. At various times, the Company had cash balances at certain financial institutions in excess of federally insured limits. However, the Company does not believe that it is subject to unusual credit risk beyond the normal credit risk associated with commercial banking relationships.

Credit risk is generally diversified due to the large number of customers that make up the Company's customer base and their geographic dispersion. The Company performs an ongoing credit evaluation of its customers. In 2009, billings to one customer represented 9.1% of the Company's consolidated revenue or 9.8% of revenue from the Integration segment. In 2009, accounts receivable from one customer represented 10.7% of the Company's consolidated net accounts receivable. Revenues from government agencies were 34.2%, 36.7% and 40.7% of total revenue for the years ended December 31, 2009, 2008 and 2007, respectively.

There are a few vendors from whom we obtain devices and software for specific access control, imaging, remote transmission, smart key and mobile applications. The loss of any one of these companies as suppliers could have a materially adverse impact on our business, financial condition and results of operations if we are unable to develop or acquire new technologies from other sources. We believe there are alternative vendors to source such products.

Timely vendor deliveries of equipment meeting our quality control standards from all suppliers are also important to our business because each installed system requires the integration of a variety of elements to be fully functional. The failure to deliver any component when required, in operating condition, can delay the project, triggering contract penalties, delay in progress payments and may result in cancellation of the project.

(l) Income Taxes

Deferred taxes are provided on the asset and liability method whereby assets and liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts reported for financial statement purposes and corresponding amounts for tax purposes. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

(m) Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, which include cash equivalents, accounts receivable, accounts payable, accrued expenses, short and long-term debt, approximate their fair values as of December 31, 2009.

(n) Marketing and Advertising Costs

The Company expenses marketing and advertising cost when the marketing and advertisement occurs. Total marketing and advertising expenses amounted to approximately $106,669, $93,599 and $63,759 for the years ended December 31, 2009, 2008 and 2007, respectively.

(o) Stock Based Compensation

The Company follows Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Shared-Based Payment," (SFAS No. 123R). SFAS No. 123R requires recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements over the period that the employee is required to perform services in exchange for the award. SFAS No. 123R also requires measurement of the cost of employee services received in exchange for an award based on the grant date fair value of the award. The Company adopted SFAS No. 123R using the modified prospective method. Under this application, the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption.< /font>

(p) Warranty

The Company offers warranties on all products, including parts and labor that ranges from one to three years, depending upon the product. For products made by others, the Company passes along the manufacturer's warranty to the end user. For the years ended December 31, 2009, 2008 and 2007, warranty expense was $102,357, $40,155 and $44,868, respectively.

(q) Net (Loss) Earnings Per Share

The computation of basic (loss) earnings per share is based upon the weighted average number of shares of common stock outstanding during the period. The computation of diluted loss per share excludes the dilutive effects of common stock equivalents such as options and warrants. Potentially dilutive securities are not included in loss per share for the years ended December 31, 2009 and 2007 as their inclusion would be antidilutive.

The following securities were not included in the computation of diluted net loss per share as their effect would have been anti-dilutive:

	December 31,	
	2009	**2007**
Options to purchase common stock	39,837	50,834
Shares issued in connection with the acquisition of Securus Inc., held in escrow	150,001	150,001

(r) Segment Information

FASB issued Statement of Financial Accounting Standards No. 131, " *Disclosure about Segments of an Enterprise and Related Information* " ("Statement 131"), that establish standards for the reporting by public business enterprises of financial and descriptive information about reportable operating segments in annual financial statements and interim financial reports issued to shareholders. The Company has identified two operating segments in which it operates; Security Systems Integration ("Integration") and Specialty Products and services ("Specialty"). The Integration segment provides design, installation and support services for a wide variety of security, communications and control systems. The Company specializes in turn-key systems that integrate many different technologies. Systems are customized to meet the specific needs of its customers. The Spe cialty Products and Services segment ("Specialty") includes the Company's emergency preparedness planning programs business and its wireless business specializes in designing, manufacturing and maintaining wireless communications equipment used to enhance and extend emergency radio frequency services and cellular communication for both fixed and mobile applications.

Each of the Company's segments market nationwide with an emphasis in the Arizona, California, Colorado, Maryland, New Jersey, New York, Texas and Virginia metropolitan areas. Customers are primarily medium and large businesses and governmental agencies. The Company derives a majority of its revenues from project installations and, to a smaller extent, maintenance service revenue.

(s) Recent Accounting Pronouncements

In June 2009, the FASB issued guidance now codified as FASB ASC Topic 105, "Generally Accepted Accounting Principles," as the single source of authoritative nongovernmental U.S. GAAP. FASB ASC Topic 105 does not change current U.S. GAAP, but is intended to simplify user access to all authoritative U.S. GAAP by providing all authoritative literature related to a particular topic in one place. All existing accounting standard documents will be superseded and all other accounting literature not included in the FASB Codification will be considered non-authoritative. These provisions of FASB ASC Topic 105 are effective for interim and annual periods ending after September 15, 2009 and, accordingly, are effective for the Company for the current fiscal reporting period. The adoption of this pronouncement did not have an impact on the Company's financial condition or results of operations, but will impact our financial reporting process by eliminating all references to pre-codification standards. On the effective date of this Statement, the Codification superseded all then-existing non-SEC accounting and reporting standards, and all other non-grandfathered non-SEC accounting literature not included in the Codification became non-authoritative.

In April 2008, the FASB issued additional guidance within ASC 350-30, General Intangibles Other than Goodwill ("ASC 350-30"). The required provisions within ASC 350-30 amend the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under the prior guidance within ASC 350 Intangibles — Goodwill and Other . The guidance shall be applied prospectively to intangible assets acquired after adoption, and the disclosure requirements shall be applied prospectively to all intangible assets recognized as of, and subsequent to, adoption. ASC 350-30 is intended to improve the consistency between the useful life of an intangible asset determined under prior requirements within ASC 350 and the period of expected cash flows used to measure the fair value of the asset under ASC 805 and other GAAP. We hav e evaluated the new statement and have determined that it does not have a significant impact on the determination ore reporting of our financial results.

In April 2009, the FASB amended Fair Value Accounting to provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased and also provides guidance on identifying circumstances that indicate a transaction is not orderly. We have evaluated the new statement and have determined the adoption did not have a material impact on the Consolidated Financial Statements.

In May 2009, the FASB issued guidance now codified as FASB ASC Topic 855, "Subsequent Events," which establishes general standards of accounting for, and disclosures of, events that occur after the balance sheet date but before financial statements are issued. This pronouncement is effective for interim or fiscal periods ending after June 15, 2009. The adoption of this pronouncement did not have a material impact on our consolidated financial position, results of operations or cash flows. However, the provisions of FASB ASC Topic 855 resulted in additional disclosures with respect to subsequent events. The Company evaluated all events or transactions that occurred after December 31, 2009 up through the date we filed this annual report on Form 10-K. During this period no material subsequent events came to our attention.

In April 2009, the FASB issued guidance now codified as FASB ASC Topic 825, "Financial Instruments," which amends previous Topic 825 guidance to require disclosures about fair value of financial instruments in interim as well as annual financial statements. This pronouncement is effective for periods ending after June 15, 2009. The adoption of this pronouncement did not have a material impact on our consolidated financial position, results of operations or cash flows.

2. ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following:

	December 31, 2009	December 31, 2008
Completed contracts, including retentions	$ 4,407,312	$ 2,829,701
Contracts in progress:	8,358,033	16,135,671
	12,765,345	18,965,372
Less: Allowance for doubtful accounts	712,206	801,306
	$ 12,053,139	$ 18,164,066

At December 31, 2009 and 2008, the largest accounts receivable from any one customer represented 10.7% and 10.1% of the net accounts receivable, respectively.

3. COSTS AND BILLINGS ON UNCOMPLETED CONTRACTS

Costs and billing on uncompleted contracts consisted of the following:

	December 31, 2009	December 31, 2008
Cost incurred on uncompleted contracts	$ 46,259,927	$ 68,235,896
Billings on uncompleted contracts	41,824,268	64,730,546
	$ 4,435,659	$ 3,505,350

Included in accompanying Balance Sheets under the following captions:

	December 31, 2009	December 31, 2008
Costs in excess of billings and estimated profits	$ 6,003,533	$ 5,512,101
Billing in excess of costs and estimated profits	1,567,874	2,006,751
	$ 4,435,659	$ 3,505,350

4. INVENTORY

Inventories consisted of the following:

	December 31, 2009	December 31, 2008
Component parts	$ 160,318	$ 166,254
Finished goods	1,542,169	1,810,762
	1,702,487	1,977,016
Less: Valuation allowance	(457,181)	(775,539)
Net inventory	$ 1,245,306	$ 1,201,477

5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	December 31, 2009	December 31, 2008

Office equipment	$ 556,141	$ 518,156
Demo and testing equipment	430,104	330,403
Automotive equipment	2,256,036	2,114,458
Computer equipment	1,703,077	1,669,172
Machinery and equipment	437,043	293,659
Leasehold improvements	436,304	396,551
	5,818,705	5,322,399
Less: Accumulated depreciation	(3,564,651)	(2,993,961)
	$ 2,254,054	$ 2,328,438

Depreciation expense was $872,181, $672,881 and $689,884 for the years ended December 31, 2009, 2008 and 2007, respectively.

Equipment under capital leases included in Property and Equipment are as follows:

	December 31,	
	2009	2008
Automotive equipment	$ 1,476,423	$ 1,187,543
Less: Accumulated depreciation	(745,008)	(420,249)
	$ 731,415	$ 767,294

6. GOODWILL

Goodwill consisted of the following:

	December 31	
	2009	2008
National Safe of California, Inc.	$ 483,753	$ 483,753
Photo Scan Systems, Inc.	472,475	472,475
Henry Bros. Electronics, LLC (Arizona)	317,114	317,114
Airolite Communications, Inc.	250,034	250,034
Securus, Inc.	971,210	971,210
CIS Security Systems Corp.	1,252,600	1,059,200
Southwest Securityscan, Inc.	38,294	38,294
	$ 3,785,480	$ 3,592,080

In 2009, 2008 and 2007 there were no charges to operations resulting from management's goodwill impairment evaluation.

7. INTANGIBLE ASSETS

Intangible assets consist of the following:

	Amortizable Intangibles						
	Acquired Customer List	Service Rights	Covenant Not to Compete	Trade Name	Total Amortizable Intangibles	Trade Name	Total Intangibles
Gross carrying value:							
December 31, 2007	959,998	436,649	287,773	36,001	1,720,421	315,114	2,035,535
Additions (deletions)	—	—	—	—	—	—	—
Impairment charge	—	—	—	—	—	—	—
December 31, 2008	959,998	436,649	287,773	36,001	1,720,421	315,114	2,035,535
Additions (deletions)	40,230	—	—	—	40,230	—	40,230
Impairment charge	—	—	—	—	—	—	—
December 31, 2009	1,000,228	436,649	287,773	36,001	1,760,651	315,114	2,075,765
Accumulated amortization:							
December 31, 2007	(291,553)	(236,661)	(287,773)	(36,001)	(851,988)	—	(851,988)
2008 Amortization	(118,690)	(48,193)			(166,883)		(166,882)
Impairment charge	—	—	—	—	—	—	—
December 31, 2008	(410,243)	(284,854)	(287,773)	(36,001)	(1,018,871)	—	(1,018,870)
2008 Amortization	(119,950)	(48,192)	—	—	(168,142)	—	(168,143)
Impairment charge	—	—	—	—	—	—	—
December 31, 2009	(530,193)	(333,046)	(287,773)	(36,001)	(1,187,013)	—	(1,187,013)
Net carrying value	$ 470,035	$ 103,603	$ —	$ —	$ 573,638	$ 315,114	$ 888,752
Weighted average life in years	11	6	3	5	6		

Amortization expense was $168,143, $166,882, and $208,868 for the years ended December 31, 2009, 2008 and 2007, respectively.

Future amortization expense for the next five years is as follows:

December 31		
2010	$	169,072
2011		125,120
2012		125,120
2013		99,471
2014		41,086

8. LONG-TERM DEBT

On June 30, 2005, the Company entered into a loan agreement (the "Loan Agreement") with TD Bank, N.A. pursuant to which TD Bank extended a $4 million two-year credit facility (the "Revolving Loan"), to the Company and refinanced $1 million of existing indebtedness to TD Bank into a five year term loan (the "Term Loan").

On October 6, 2008, the Company executed its fourth amendment to the Revolving Loan with TD Bank, increasing its line of credit from $4 million to $8 million. The Revolving Loan is subject to certain borrowing base limitations. On November 11, 2009 the term of the Revolving Loan has been extended to June 30, 2011. Advances under the Revolving Loan may be used to finance working capital and acquisitions. Interest is paid monthly in arrears at TD Bank's prime rate (3.25% at both December 31, 2009 and December 31, 2008). As part of the extension of the Term Loan to June 30, 2011, the interest rate will now be subject to a minimum floor rate of 4.0%. TD Bank has a first priority security interest on the Company's accounts receivable and inventory.

The Term Loan provided for the payment of sixty equal monthly installments of principal and interest in the amount of $19,730 commencing July 30, 2005 and continued through June 30, 2009. Interest under the Term Loan was 6.75%.

The Company is required to maintain certain financial and reporting covenants and is restricted from paying dividends under the terms of the Loan Agreement. The company was not in compliance with one of the covenants at December 31, 2009. The Company received a waiver from TD Bank on March 12, 2010.

Long-term debt included the following balances:

	December 31,			
		2009		2008
Term loan at 6.75% interest payable in monthly installments of $19,730 thru June 01, 2009	$	—	$	103,410
Revolving line at the prime rate of interest, payable in monthly installments thru June 30, 2011		4,335,898		4,335,898
Corporate insurance financed at 5.99% payable in monthly installments thru September 01, 2010		194,665		268,992
Capitalized lease obligations due in monthly installments, with interest ranging from 6.4% to 12.7%		836,506		777,104
		5,367,069		5,485,404
Less: Current Portion		(536,552)		(629,742)
	$	4,830,517	$	4,855,662

The weighted average prime interest rate was 3.25% and 4.8% for the years ended December 31, 2008 and 2009, respectively.

Aggregate maturities of all outstanding debt at December 31, 2009:

2010	$	481,165
2011		4,623,654
2012		184,959
2013		77,291
	$	5,367,069

Future minimum lease payments for assets under capital leases outstanding at December 31, 2009:

2010	$	347,018
2011		358,332
2012		218,595
2013		87,386
		1,011,331
Less: Amount representing interest		(174,825)
Present value of net minimum lease payments	$	836,506

9. INCOME TAXES

The tax provision consists of the following:

Years Ended December 31,		
2009	2008	2007

Federal:			
Current	$ (281,705)	$ 821,398	$ 5,869
Deferred	84,844	138,507	24,465
	(196,861)	959,905	30,334
State:			
Current	138,890	464,027	63,934
Deferred	(60,421)	(49,612)	30,987
	78,469	414,415	32,947
	$ (118,392)	$ 1,374,320	$ 63,281

The components of the deferred tax asset (liability) as of December 31, 2009 and 2008 are as follows:

	2009	2008
Deferred Tax Asset:		
Allowance for doubtful accounts	$ 279,917	$ 331,330
Accrued absences	218,298	237,991
Accrued warranty	183,463	219,514
Bonus accrual	99,647	276,120
Inventory	183,693	321,479
Deferred rent	63,372	43,436
Stock compensation	67,385	93,542
Accrued commissions	249,723	—
Net operating loss / charitable contribution carry forward	566,505	624,694
Less: valuation allowance	(85,108)	(159,102)
Total deferred tax asset	$ 1,826,895	$ 1,989,004
Deferred Tax Liability:		
Deferred revenue	$ —	$ (66,561)
Depreciation	(508,527)	(503,838)
Goodwill	(82,702)	(83,228)
Intangible assets	(303,073)	(378,485)
Total deferred tax liability	$ (894,302)	$ (1,032,112)
Net deferred tax asset	$ 932,593	$ 956,892
Net short-term asset	$ 1,251,443	$ 1,363,309
Net long-term (liability) asset	$ (318,850)	$ (406,417)

The Company has approximately $1.0 million and $5.7 million of federal and state net operating loss carryforwards as of December 31, 2009. Some of the net operating loss carryforwards were acquired and are subject to limitation under Internal Revenue Code Section 382.

A valuation allowance is provided when it is more likely than not that some portion of deferred tax assets will not be realized. The Company has a valuation allowance of approximately $85,000 as of December 31, 2009 to account for a portion of the Company’s State deferred tax assets including State net operating loss carryforwards that are not more likely than not to be realized. The valuation allowance decreased by approximately $74,000 for the year ended December 31, 2009 due to the utilization of State net operating loss carryforwards that were previously deemed unrealizable.

The provision for income taxes differs from that computed using the United States statutory tax rate of 34% due to the following:

	Years Ended December 31,		
	2009	2008	2007
Provision (benefit) for taxes using statutory rate	$ (320,275)	$ 996,906	$ (81,608)
State taxes, net of federal tax benefit	159,769	218,412	10,823
FIN 48 state additional exposure (reduction)	(6,203)	7,766	8,539
Change in valuation allowance	(73,994)	—	—
State taxes, net of federal tax benefit-change in estimated rate	—	—	1,841
Change in prior year deferred tax estimates - State	—	6,880	5,280
Change in prior year deferred tax estimates - Federal	—	31,397	23,076
Permanent differences:			
Goodwill impairment	—	—	14,960
Goodwill tax amortization	—	—	(8,651)
Qualified stock based compensation	78,779	91,602	66,585
Other non-deductible expenses	43,532	21,357	22,435
Provision (benefit) for income taxes	$ (118,392)	$ 1,374,320	$ 63,280

The Company adopted FASB provisions for accounting for uncertainty in income taxes as of January 1, 2007. As a result of this adoption, the Company recognized an approximate $38,561 increase in the liability for unrecognized tax benefits and a decrease to the January 1, 2007 balance of retained earnings. There were no additional tax liabilities identified in 2008 or 2009, except for the potential additional interest on those liabilities recognized at December 31, 2007. As of December 31, 2009 and 2008, the Company had $48,663 and $54,866, respectively, of unrecognized income tax benefits, all of which would affect the Company’s effective tax rate if recognized.

A reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits as of and during the years ended December 31, 2009 and 2008 follows:

	Years Ended December 31, 2009		Years Ended December 31, 2008	
Gross unrecognized income tax benefits beginning of year	$	54,866	$	47,100
Reductions for tax positions due to statute of limitations expiration		(7,247)		—
Additions for the tax positions of prior years		1,044		7,766
Gross unrecognized income tax benefits at end of year	$	48,663	$	54,866

The Company has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The Company has identified its federal consolidated tax return and its state tax returns in New York, New Jersey and California as major tax jurisdictions, as defined. The only periods subject to examination for the Company's federal return are the 2006 through 2009 tax years. The periods subject to examination for the Company's state returns in New York, New Jersey and California are years 2005 through 2009. The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits in income tax expense. At December 31, 2009 and 2008, the Company recognized approximately $1,044 and $9,224, respectively, in potential interest and penalties associated with uncertain tax position s. The change in the unrecognized tax benefit within the next 12 months is not expected to be material to the financial statements.

10. INCENTIVE STOCK OPTION PLAN

The Company has a Stock Option Plan (the "1999 Plan"), for the benefit of employees of the Company, under which options to purchase up to a maximum of 500,000 shares of its common stock may be issued. The maximum term of any option is ten years, and the option price per share may not be less than the fair market value of the Company's shares at the date the option is granted. However, options granted to persons owning more than 10% of the voting shares will have a term not to exceed five years, and the option price will not be less than 110% of fair market value. Options granted to an optionee will usually vest 33 1/3% annually, beginning on the first anniversary of the option grant, subject to the discretion of the Compensation Committee of the Board of Directors. The 1999 Plan terminated on December 23, 2009 . Any option outstanding at the termination date remains o utstanding until it expires or is exercised in full, whichever occurs first.

On May 10, 2002, the Board of Directors approved the 2002 Incentive Stock Option Plan (the "2002 Plan"), which the shareholders subsequently approved on October 28, 2002. On August 2, 2006, the Board of Directors approved the 2006 Stock Option Plan (the 2006 Plan"), which the shareholders subsequently approved on November 1, 2006. On November 8, 2007, the Board of Directors approved the 2007 Stock Option Plan (the "2007 Plan"), which the shareholders subsequently approved on November 12, 2007.

The 2002, 2006 and 2007 Plans (collectively "the Plans") allow the granting of incentive stock options or non-qualified stock options to the Company's employees, directors and consultants, up to a maximum of 230,000, 250,000 and 250,000 shares of its common stock for the 2002, 2006 and 2007 Plans, respectively. All stock options granted under the Plans will be exercisable at such time or times and in such installments, if any, as our Compensation Committee or the Board may determine and expire no more than ten years from the date of grant. The 2002 Plan will terminate on May 9, 2012, the 2006 Plan will terminate on August 2, 2016, and the 2007 Plan will terminate on November 8, 2017, or such earlier date as the Board of Directors may determine. Any option outstanding at the termination date will remain outstanding until it expires or is exercised in full, whicheve r occurs first. The exercise price of the stock option will be at fair market value. Vesting is at the discretion of the Compensation Committee. The Plans allow for immediate vesting if there is a change of control. As of December 31, 2009, in total, 245,485 options are available for future grant under the 2002, 2006 and 2007 Plans. The Company charged $362,361, $281,938, and $227,839 to operations for the years ended December 31, 2009, 2008 and 2007, respectively, for the fair value of those options granted subsequent to January 1, 2003.

A summary of stock option activity under the Plan's follows:

	Number of Shares		Price			
	Outstanding	Exercisable	Outstanding		Exercisable	
December 31, 2006	670,600	290,435	$	5.17	$	6.37
Granted at market	309,800			4.32		
Exercised	—					
Terminated	(63,500)			5.39		
December 31, 2007	916,900	354,620		4.87		5.68
Granted at market	128,000			5.56		
Exercised	(21,218)			5.07		
Terminated	(39,167)			5.03		
December 31, 2008	984,515	496,856		4.97		5.44
Granted at market	88,000			5.31		
Exercised	(43,783)			4.65		
Forfeited or expired	(30,933)			6.49		
December 31, 2009	997,799	628,866	$	4.96	$	5.17

A summary of the status of the Company's nonvested shares as of December 31, 2009 and changes during the year ended December 31, 2009 is presented below:

Nonvested Shares	Shares	Grant Date Fair Value

Nonvested at December 31, 2007	562,280	$	1.91
Granted	128,000		2.56
Vested	(237,918)		1.75
Forfeited (nonvested)	(35,297)		2.03
Nonvested at December 31, 2008	417,065		2.00
Granted	88,000		2.42
Vested	(122,799)		1.93
Forfeited (nonvested)	(13,333)		2.07
Nonvested at December 31, 2009	368,933	$	2.11

As of December 31, 2009, there was $552,460 of total unrecognized compensation cost related to nonvested share-based compensation arrangements under the Plan. That cost is expected to be recognized over a weighted-average period of 2.8 years.

The aggregate fair value of options outstanding at December 31, 2009, was $1,739,886 and had a weighted-average remaining contractual life of 2.7 years. Of these options outstanding, 628,866 were exercisable and 368,933 were expected to vest, and had an aggregate fair value of $759,547 with a weighted-average remaining contractual life of 3.7 years. The following table provides information related to options exercised during the years ended December 31:

	2009	2008	2007
Total intrinsic value	$ 59,421	$ 146,701	—
Cash received upon exercise	203,669	119,258	—
Related tax benefits realized	12,784	11,391	—

Stock based compensation is being amortized over the vesting period of up to five years. The fair value of the Company's stock option awards was estimated assuming no expected dividends and the following weighted-average assumptions for the years ended December 31:

	2009	2008	2007
Expected Life (years)	5.4	4.3	4.0
Expected volatility	49.4%	42.9%	51.9%
Risk-free interest rates	1.7%	2.9%	4.1%
Dividend yield	—	—	—
Weighted-average grant-date fair value	$ 2.42	$ 2.56	$ 2.16

The assumptions above are based on multiple factors, including historical exercise patterns of employees with respect to exercise and post-vesting employment termination behaviors, expected future exercise patterns for these employees and the historical volatility of our stock price. The expected term of options granted is derived using company-specific, historical exercise information and represents the period of time that the options granted are expected to be outstanding. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

11. STOCKHOLDERS' EQUITY

In connection with the acquisition of all the capital stock of CIS Security Systems Corp. ("CIS") on October 2, 2006, the Company issued an aggregate of 20,000 shares of its common stock, valued at $67,200. The Company issued an additional 55,000 shares of its restricted common stock in 2009, 2008 and 2007 to CIS's selling shareholder after CIS met certain performance targets. The issuance of the shares of restricted stock in connection with the aforementioned acquisition was made in reliance upon the exemption provided in section 4(2) of the Securities Act of 1933, as amended. In addition, the selling shareholder may earn an additional 25,000 shares of the Company's common stock if CIS achieves certain performance targets through December, 2011.

In connection with the acquisition of Securus, Inc. on October 10, 2005, the Company issued an aggregate of 150,001 shares of its common stock, all of which are being held in escrow pursuant to the stock purchase escrow agreement between the Company and the selling shareholders of Securus, Inc. These shares held in escrow may be earned out through December 31, 2010 based upon the aggregate value of the earnings before interest and tax ("EBIT") to $2,960,000.

The issuance of the shares of restricted stock, in connection with the aforementioned acquisition, was made in reliance upon the exemption provided in section 4(2) of the Securities Act of 1933, as amended.

Holders of common stock are entitled to one vote for each share held on all matters submitted for a vote of stockholders and do not have cumulative voting rights. Apart from preferences that may be applicable to any shares of preferred stock outstanding at the time, holders of our common stock are entitled to receive dividends ratably, if any, as may be declared from time to time by our board of directors out of funds legally available. Upon the liquidation, dissolution or winding up of the Company, the holders of common stock are entitled to receive ratably the net assets available after the payment of all liabilities and liquidation preferences on any outstanding preferred stock. Holders of common stock have no preemptive, subscription, redemption or conversion rights, and there are no redemption or sinking fund provisions applicable to the common stock.

Preferred Stock — Our board of directors is authorized, without stockholder approval, to issue up to 2,000,000 shares of preferred stock in one or more series and to fix the rights, preferences, privileges and restrictions of these shares, including dividend rights, conversion rights, voting rights, terms of redemption and liquidation preferences, and to fix the number of shares constituting any series and the designations of these series. These shares may have rights senior to our common stock. The issuance of preferred stock may have the effect of delaying or preventing a change in control. The issuance of preferred stock could decrease the amount of earnings and assets available for distribution to the holders of our common stock or could adversely affect the rights and powers, including voting rights, of the holders of our common stock. At present, we have no plans to issue preferred stock in the foreseeable future.

A total of 166,400 common shares are available for issuance of employee stock options and warrants as of December 31, 2009.

12. COMMITMENTS

Leases - The Company leases its office and warehouse facilities under operating leases that expire through 2016. Future minimum rental payments, under non-cancelable leases as of December 31, 2009, are as follows:

2010	$	602,877
2011		540,059
2012		364,995
2013		263,800
2014		245,181
Thereafter		439,903
	$	2,456,815

Rent expense under operating leases was $820,817, $890,778, and $754,258 for the years ended December 31, 2009, 2008 and 2007, respectively.

13. EMPLOYEE BENEFIT PLAN

As of January 1, 2003, the Company sponsored a 401-K plan, including discretionary profit sharing (the “401-K Plan”). As of September 1, 2003, the Company decided to discontinue matching employee contributions to the 401-K Plan, but resumed discretionary matches in 2008. The Company has implemented a match for 2008 and 2009 whereby the Company matched 25% of employee’s contributions, up to 10% of the employee’s salary, with a maximum match of $750. An expense of $76,483 and $73,879 was recorded for the years ended December 31, 2009 and 2008, respectively, associated with the Company matching contribution. The Company plans to continue the same discretionary match in 2010. The Company’s contributions to the employees’ accounts vest equally over three years and the employee contribution to their own account vests immediately. There were no Company matching contri butions to the 401-K plan during 2007.

14. RELATED PARTY TRANSACTIONS

Joseph P. Ritorto, a member of our Board of Directors since January 2002, was co-founder of First Aviation Services, Inc. (“First Aviation”). Mr. Ritorto sold First Aviation to a group led by Goldman Sachs in May 2008. In 2007 the Company had revenues of $546,375 principally associated with an integrated security systems project with First Aviation. During the period in 2008 that the business was owned by Mr. Ritorto, the Company had no revenues from First Aviation. There are no outstanding accounts receivable due from First Aviation at December 31, 2009 related to the period that the business was owned by Mr. Ritorto.

Richard D. Rockwell, a member of the Board of Directors since November 2007, has been Owner and Chairman of Professional Security Technologies LLC, a full service security systems integrator since 1996. The Company had revenues of $120,130, $51,447 and $4,787 for the years 2009, 2008 and 2007, respectively. These revenues were principally related to the sale of equipment. There was a balance of $39,192 in accounts receivable as of December 31, 2009.

15. CONTINGENT LIABILITIES

We know of no material litigation or proceeding, pending or threatened, to which we are or may become a party.

From time to time, the Company is subject to various claims with respect to matters arising out of the normal course of business. In management’s opinion, none of these claims is likely to have a material effect on the Company’s consolidated financial statements.

16. SEGMENT DATA

Selected information by business segment is presented in the following tables for the years ended December 31:

	For the year ended December 31,					
		2009		2008		2007
Revenue						
Integration	$	53,089,756	$	60,843,182	$	56,332,837
Specialty		2,283,713		1,514,284		2,147,355
Inter-segment		(268,000)		—		(627,976)
Total revenue	$	55,105,469	$	62,357,466	$	57,852,216
Operating Profit						
Integration	$	2,267,910	$	7,019,073	$	3,159,353
Specialty		703,468		(625,431)		(544,471)
Corporate		(3,700,311)		(3,299,100)		(2,578,300)
Total operating profit	$	(728,933)	$	3,094,542	$	36,582

Selected balance sheet information by business segment is presented in the following table as of December 31:

	December 31, 2009		December 31, 2008
Total Assets:			
Integration	$ 27,309,364		$ 33,304,890
Specialty	1,454,812		1,756,730
Corporate	3,928,119		1,548,488
Total assets	$ 32,692,295		$ 36,610,108

17. ACQUISITIONS

On October 2, 2006, the Company consummated the acquisition of all the capital stock of CIS Security Systems Corp. ("CIS"), a privately-held security systems integrator with offices in Baltimore, Maryland and Newington, Virginia, for an aggregate purchase price of $1,545,973 ($850,000 in cash to the selling shareholder, the assumption and subsequent repayment of CIS debt in the amount of $603,364, the issuance of 20,000 shares of the Company's $0.01 par value common stock valued at $67,200 and $25,409 in transaction costs). In addition, the selling shareholder may earn an additional amount up to $250,000 in cash and 80,000 additional shares of the Company's common stock if CIS achieves certain performance targets through December, 2011. As of December 31, 2009, on a cumulative basis the selling shareholder has earned $137,500 in cash and 55,000 additional shares (valued at $297,400) of the Company's common stock through the achievement of certain performance targets, which resulted in the$193,400, $213,050 and $62,500 additional goodwill during each of the years ended December 31, 2009, 2008 and 2007, respectively.

Established in 1987, CIS provides design, engineering and installation services for integrated electronic security systems for both commercial and government clients in the Washington-Baltimore metropolitan area. CIS also provides design-build services for large-scale security systems for malls, shopping centers and stadiums throughout the country.

18. QUARTERLY FINANCIAL INFORMATION (UNAUDITED):

Presented below is a schedule of selected quarterly operating results:

	First Quarter Ended March 31	Second Quarter Ended June 30	Third Quarter Ended Sept. 30	Fourth Quarter Ended Dec. 31 (1)
Year Ended December 31, 2009				
Revenue	$ 15,308,212	$ 13,971,980	$ 12,109,037	$ 13,716,240
Gross profit	4,222,014	3,890,109	3,022,057	3,122,736
Net income	166,122	55,253	(357,382)	(687,950)
Earnings per share				
Basic	$ 0.03	$ 0.01	$ (0.06)	$ (0.12)
Diluted	0.03	0.01	(0.06)	(0.12)
Year Ended December 31, 2008				
Revenue	$ 15,906,046	$ 15,123,950	$ 12,262,372	$ 19,065,098
Gross profit	3,689,108	3,841,951	3,612,452	4,748,761
Net income	283,957	337,261	210,782	725,756
Earnings per share				
Basic	$ 0.05	$ 0.06	$ 0.04	$ 0.12
Diluted	0.05	0.06	0.04	0.12

Earnings (loss) per share are computed independently for each of the quarters presented, on the basis described in Note 1. The sum of the quarters may not be equal to the full year earnings per share amount.

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(1) The Company's decrease in net income (loss) is principally the result of the overall declines in revenues due to the protracted credit freeze and economic downturn, which is having a significant negative impact on construction markets and capital spending patterns of commercial businesses.

Exhibit 99.2

HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES
INDEX TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2010 (unaudited)	December 31, 2009 (audited)
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,973,337	$ 2,917,046
Accounts receivable-net of allowance for doubtful accounts of $704,046 at September 30, 2010 and $712,206 at December 31, 2009	18,093,381	12,053,139
Inventory	1,828,204	1,245,306
Cost and estimated profit in excess of billing	9,031,520	6,003,533
Deferred tax asset	1,198,184	1,251,443
Retainage receivable	883,964	295,928
Prepaid expenses and income tax receivable	603,778	1,423,541
Other assets	158,950	161,479
Total current assets	33,771,318	25,351,415
Property and equipment - net of accumulated depreciation of $4,187,087 at September 30, 2010 and $3,564,650 at December 31, 2009	1,997,961	2,254,054
Goodwill	4,760,730	3,785,480
Intangible assets - net of accumulated amortization of $1,321,000 at September 30, 2010 and $1,187,013 at December 31, 2009	944,765	888,752
Other assets	290,069	412,594
TOTAL ASSETS	$ 41,764,843	$ 32,692,295
LIABILITIES & STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 8,738,888	$ 5,360,471
Accrued expenses	4,568,049	3,507,060
Accrued taxes	106,701	—
Billing in excess of cost and estimated profit	2,763,154	1,567,874
Deferred income	357,232	136,574
Current portion of long-term debt	299,625	536,552
Other current liabilities	642,774	494,017
Total current liabilities	17,476,423	11,602,548
Long-term debt, less current portion	5,557,786	4,830,517
Deferred tax liability	501,314	318,850
Other liabilities	231,344	—
TOTAL LIABILITIES	23,766,867	16,751,915
STOCKHOLDERS' EQUITY		
Common stock, $.01 par value; 20,000,000 shares authorized 6,210,366 shares issued and outstanding in 2010 and 6,035,366 in 2009	62,104	60,354
Additional paid in capital	19,314,838	18,437,288
Accumulated deficit	(1,378,966)	(2,557,262)
TOTAL EQUITY	17,997,976	15,940,380
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$ 41,764,843	$ 32,692,295

See accompanying notes to the condensed consolidated financial statements.

HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Nine months ended September 30,		Three months ended September 30,	
	2010	2009	2010	2009

Revenue	$ 46,937,305	$ 41,389,229	$ 19,345,013	$ 12,109,037
Cost of revenue	33,502,994	30,255,049	13,608,160	9,086,980
Gross profit	13,434,311	11,134,180	5,736,853	3,022,057
Operating expenses:				
Selling, general & administrative expenses	10,710,057	11,015,124	3,947,944	3,452,480
Merger and acquisition costs	539,846	—	539,846	—
Operating profit (loss)	2,184,408	119,056	1,249,063	(430,423)
Interest income	70,668	21,023	14,335	11,986
Other income (expense)	4,449	29,274	(16)	13,481
Interest expense	(174,874)	(222,333)	(63,089)	(56,926)
Income (loss) before income tax expense	2,084,651	(52,980)	1,200,293	(461,882)
Income tax expense (benefit)	906,355	83,027	473,188	(104,500)
Net income (loss)	$ 1,178,296	$ (136,007)	$ 727,105	$ (357,382)
BASIC EARNINGS (LOSS) PER COMMON SHARE:				
Basic earnings (loss) per common share	$ 0.19	$ (0.02)	$ 0.12	$ (0.06)
Weighted average common shares	6,068,553	5,859,400	6,123,518	5,877,798
DILUTED EARNINGS (LOSS) PER COMMON SHARE:				
Diluted earnings (loss) per common share	$ 0.19	$ (0.02)	$ 0.12	$ (0.06)
Weighted average diluted common shares	6,124,694	5,859,400	6,179,659	5,877,798

See accompanying notes to the condensed consolidated financial statements.

HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the nine months ended September 30,	
	2010 (unaudited)	2009 (unaudited)
Cash flows from operating activities:		
Net income (loss)	$ 1,178,296	$ (136,007)
Adjustments to reconcile net income from operations to net cash provided by (used in) operating activities:		
Depreciation and amortization	751,853	692,877
Bad debt expense	69,360	292,391
Stock option expense	192,500	266,500
Deferred income taxes	235,723	232,177
Changes in operating assets and liabilities:		
Accounts receivable	(6,109,603)	6,411,725
Inventory	(568,134)	26,807
Costs in excess of billings and estimated profits	(3,027,987)	303,892
Retainage receivable	(588,036)	466,040
Other assets	125,054	(65,172)
Prepaid expenses and income tax receivable	819,763	(517,176)
Accounts payable	3,378,417	(2,646,020)
Accrued expenses	998,489	(1,704,843)
Taxes payable	106,701	(200,774)
Billings in excess of costs and estimated profits	1,195,280	(679,666)
Deferred income	220,658	(100,048)
Other liabilities	(11,243)	(96,079)
Net cash (used in) provided by operating activities	(1,032,909)	2,546,624
Cash flows from investing activities:		
Purchase of businesses	(118,311)	(50,000)
Purchase of property and equipment	(86,035)	(291,026)
Net cash used in investing activities	(204,346)	(341,026)
Cash flows from financing activities:		
Proceeds from exercising of stock options - net of fees	—	203,669
Borrowings under revolving loan agreement	3,325,000	1,900,000
Repayments under revolving agreement	(2,600,000)	(1,750,000)
Payments of bank loans	—	(103,410)
Net repayments of other debt	(194,665)	(238,909)
Payments of equipment financing	(236,789)	(211,029)
Net cash provided by (used in) financing activities	293,546	(199,679)
(Decrease) increase in cash and cash equivalents	(943,709)	2,005,919
Cash and cash equivalents - beginning of period	2,917,046	27,704
Cash and cash equivalents - end of period	$ 1,973,337	$ 2,033,623
Supplemental disclosure of cash flow information:		
Amount paid for the period for:		
Interest	$ 160,793	$ 204,881

Taxes	66,400	707,083
Non-cash investing and financing activities:		
Equipment financed	191,389	288,140
Issuance of stock to acquire businesses	665,250	103,650

See accompanying notes to the condensed consolidated financial statements.

HENRY BROS. ELECTRONCS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock par value $0.01				Additional Paid-in		Accumulated		
	Shares		Amount		Capital		Deficit		Total
Balance at December 31, 2009 (audited)	6,035,366	$	60,354	$	18,437,288	$	(2,557,262)	$	15,940,380
Shares issued in connection with the acquisition of CIS Security Systems	25,000		250		104,550		—		104,800
Shares issued in connection with the acquisition of PST	150,000		1,500		580,500				582,000
Amortization of value assigned to stock option grants	—		—		192,500		—		192,500
Net income	—		—		—		1,178,296		1,178,296
Balance at September 30, 2010 (unaudited)	6,210,366	$	62,104	$	19,314,838	$	(1,378,966)	$	17,997,976

See accompanying notes to the condensed consolidated financial statements.

HENRY BROS. ELECTRONICS, INC AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Description of Business and Basis of Presentation

Interim Financial Statements:

The information presented as of September 30, 2010 and for the three and nine month periods ended September 30, 2010 and 2009 are unaudited, and reflect all adjustments (consisting only of normal recurring adjustments) which Henry Bros. Electronics, Inc. and its Subsidiaries (the "Company" or "HBE") considers necessary for the fair presentation of the Company's financial position as of September 30, 2010, the results of its operations for the three and nine month periods ended September 30, 2010 and 2009, and cash flows and changes in stockholders' equity for the nine month period ended September 30, 2010. The Company's December 31, 2009 balance sheet information was derived from the audited consolidated financial statements for the year ended December 31, 2009, which are included as part of the Company's Annual Report on Form 10-K.

The condensed consolidated financial statements included herein have been prepared in accordance with U.S. generally accepted accounting principles and the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. It is suggested that these condensed financial statements be read in conjunction with the Company's financial statements and notes thereto included in the Company's latest shareholders' annual report.

As of September 30, 2010, there have been no material changes to any of the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

Description of Business:

Henry Bros. Electronics, Inc. is an established player in the electronic physical security industry, specializing in integrated security systems, and emergency preparedness.

HBE provides products and services to customers in the public and private sectors. Customers include transit authorities, seaports, airports, universities, office-buildings, hospitals and airlines. Each of the Company's segments markets its products and services nationwide with an emphasis in Arizona, California, Colorado, Maryland, New Jersey, New York, Texas and Virginia.

The company operates through two primary operating segments:

1. Security Systems Integration

2. Specialty Product and Services

The Security Systems Integration business operates under the name Henry Bros. Electronics, Inc. and its approach to client service is core to all of its businesses. At the beginning of each new client relationship, HBE designates one member of its professional staff as the client service contact. This individual is the point person for communications between the client and HBE and often acts as the client's project manager for all of its security needs, which ensures that clients receive the best possible security solution to meet its needs. The Company derives a majority of its revenues from project installations and to a smaller extent, maintenance service revenue.

The Specialty Products and Services segment includes three separate businesses:

1. Evacuation planning
2. Mobile digital recording
3. Airorlite Communications

The Evacuation Planning business operates under the Diversified Security Solutions, Inc. name and works with managers of high-rise office buildings to analyze their specific facilities' needs with emergency preparedness plans. This division provides demonstrations, training and recommendations to clients; develops emergency plans and procedures; and communicates building strategy to the tenants to increase building community unity, awareness and confidence.

The Mobile Digital Recording business operates under the name Viscom Products, Inc. and has developed an integrated standard solution for the deployment of mobile digital recorders on municipal buses and trains.

The Airorlite Communications business provides specialized communications product design, development and engineering related to RF transmission.

The table below shows the sales percentages by geographic location for the following periods:

	Nine months ended September 30,	
	2010	2009
New Jersey/New York	54%	50%
California	18%	18%
Texas	7%	5%
Arizona	5%	8%
Colorado	6%	11%
Virginia / Maryland	7%	8%
Integration segment	97%	100%
Specialty segment	4%	3%
Inter-segment	-1%	-3%
Total revenue	100%	100%

2. Summary of Significant Accounting Policies:

Principles of Consolidation:

The condensed consolidated financial statements include the accounts of the Company. Acquisitions are recorded as of the purchase date, and are included in the consolidated financial statements from the date of acquisition. All material intercompany transactions have been eliminated in consolidation.

Use of Estimates:

The preparation of financial statements, in conformity with generally accepted accounting principles in the United States, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities, at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue and costs relating to security integration systems projects and service agreements are particularly affected by management's estimates. The contract sale price and estimated costs are based upon the facts and circumstances known at the time of the proposal. Estimates for the costs to complete the contract are periodically updated during the performance of the contract. Unpredictable events can occur during the performance of the contract that can increase the costs and reduce the estimated gross profit. Change orders to record additional costs may not be approved or can become subject to long negotiations with the customer and can result in concessions by the Company. Considerable judgments are made during the performance of the contract that affects the Company's revenue recognition and cost accruals that may have a significant impact on the results of operations reported by the Company.

Fair Value of Financial Instruments:

The carrying amounts of the Company's financial instruments, which include cash equivalents, accounts receivable, accounts payable, accrued expenses, short and long-term debt, approximate their fair values as of September 30, 2010.

Recently Issued Accounting Pronouncements:

In May 2009, the FASB issued guidance now codified as FASB ASC Topic 855, "Subsequent Events," which establishes general standards of accounting for, and disclosures of, events that occur after the balance sheet date but before financial statements are issued. This pronouncement is effective for interim or fiscal periods ending after June 15, 2009. The adoption of this pronouncement did not have a material impact on our consolidated financial position, results of operations or cash flows. However, the provisions of FASB ASC Topic 855 resulted in additional disclosures with respect to subsequent events. In February 2010, an update to accounting guidance was issued which eliminates the disclosure of the date through which subsequent events have been evaluated. This update was effective immediately. The adoption of this amendment did not have a significant effect on o ur financial statements.

3. Earnings Per Share

The computation of basic earnings per share is based upon the weighted average number of shares of common stock outstanding during the period. When applicable, the computation of diluted earnings per share includes the dilutive effects of common stock equivalents, less the shares that may be repurchased with the funds received from their exercise and the effect of adding back unrecognized future stock compensation expense. Potentially dilutive common stock equivalents include shares issuable upon exercise of options. Contingent shares are excluded from basic earnings per share.

4. Stock Based Compensation

For the three months ended September 30, 2010 and 2009, the Company charged $60,000 and $73,500, respectively, to operations for stock based compensation expense. For the nine months ended September 30, 2010 and 2009, the Company charged $192,500 and $266,500, respectively, to operations for stock based compensation expense. A modification to a stock option, previously issued to an executive officer, extending the term for one year, resulted in an expense in the second quarter of 2009, equal to the net increase in the fair value of the modified stock option of $49,000.

A summary of stock option activity for the nine months ended September 30, 2010 under the Company's various Stock Option Plans' follows:

	Number of Shares		Weighted Average Exercise Price	
	Outstanding	**Exercisable**	**Outstanding**	**Exercisable**
December 31, 2009 (audited)	997,799	628,866	$ 4.96	$ 5.17
Granted at market	113,000		3.86	
Exercised	—		—	
Forfeited or expired	(110,300)		7.01	
September 30, 2010 (unaudited)	1,000,499	626,232	$ 4.61	$ 4.72

Stock based compensation is being amortized over the vesting period of up to five years. The fair value of the Company's stock option awards was estimated assuming no expected dividends and the following weighted-average assumptions for the nine months ended September 30, 2010 follows:

Expected Life (years)	5.86
Expected volatility	50.6%
Risk-free interest rates	1.9%
Dividend yield	—
Weighted-average grant-date fair value	$ 1.67

There were 113,000 options issued during the nine month period ending September 30, 2010.

5. Costs and Billings on Uncompleted Contracts

Costs and billing on uncompleted contracts consisted of the following:

	September 30, 2010	December 31, 2009
Cost and estimated profit on uncompleted contracts	$ 45,998,023	$ 46,259,927
Billing on uncompleted contracts	39,729,657	41,824,268
	$ 6,268,366	$ 4,435,659

Included in accompanying Balance Sheets under the following captions:

	September 30, 2010	December 31, 2009
Cost and estimated profit in excess of billing	$ 9,031,520	$ 6,003,533
Billing in excess of cost and estimated profit	2,763,154	1,567,874
	$ 6,268,366	$ 4,435,659

6. Long-Term Debt

On June 30, 2005, the Company entered into a loan agreement (the "Loan Agreement") with TD Bank, N.A. pursuant to which TD Bank extended a $4 million two-year credit facility (the "Revolving Loan"), to the Company and refinanced $1 million of existing indebtedness to TD Bank into a five year term loan (the "Term Loan").

On October 6, 2008, the Company executed its fourth amendment to the Revolving Loan with TD Bank, increasing its line of credit from $4 million to $8 million. The Revolving Loan is subject to certain borrowing base limitations. On August 10, 2010 the term of the Revolving Loan was extended to June 30, 2012. Advances under the Revolving Loan may be used to finance working capital and acquisitions. Interest is paid monthly in arrears at TD Bank's prime rate, subject to a minimum floor rate of 4.0% effective November 11, 2009 as part of the extension of the Revolving Loan. TD Bank has a first priority security interest on the Company's accounts receivable and inventory.

The Company is required to maintain certain financial and reporting covenants and is restricted from paying dividends under the terms of the Loan Agreement.

Long-term debt included the following balances:

	September 30,	December 31,

	2010	2009
Revolving line at the prime rate of interest, subject to a minimum floor rate of 4.0% effective November 11, 2009, expires June 30, 2012	$ 5,060,898	$ 4,335,898
Corporate insurance financed at 5.99% payable in monthly installments thru September 01, 2010	—	194,665
Capitalized lease obligations due in monthly installments, with interest ranging from 6.4% to 12.7%	796,513	836,506
	5,857,411	5,367,069
Less: Current portion	(299,625)	(536,552)
	$ 5,557,786	$ 4,830,517

The weighted average interest rate on the Revolving Loan was 3.25% for the nine months ended September 30, 2010 and the year ended December 31, 2009.

7. Income Taxes

The effective income tax rate for the three months and nine months ended September 30, 2010 was 39.4% and 43.5%, respectively. An effective tax rate of 44% was applied to the loss before tax for the three months and nine months ended September 30, 2009, which was offset by the effect of permanent differences which increased taxable income. Income tax expense for interim reporting is based on an annual effective income tax rate forecast, which includes estimates and assumptions that could change during the year. The differences between the effective income tax rate and the U.S. federal statutory rate of 34% principally result from state and local taxes, and differences between the book and tax treatment of certain items, such as incentive stock options.

The effective income tax rate for the three months and nine months ended September 30, 2010 has not been impacted by any material discrete items. As of September 30, 2010 the Company has $51,053 of unrecognized income tax benefits, all of which would impact the Company's effective tax rate if recognized. There have been no significant changes during the nine months ended September 30, 2010.

8. STOCKHOLDERS' EQUITY

In connection with the acquisition of all the capital stock of CIS Security Systems Corp. ("CIS") on October 2, 2006, the Company issued an aggregate of 20,000 shares of its common stock, valued at $67,200. The Company issued an additional 60,000 shares during 2009, 2008 and 2007, and 15,000 shares during the first nine months of 2010 of its restricted common stock to CIS's selling shareholder after CIS met certain performance targets. The issuance of the shares of restricted stock in connection with the aforementioned acquisition was made in reliance upon the exemption provided in section 4(2) of the Securities Act of 1933, as amended. In addition, the selling shareholder achieved certain performance targets to earn an additional 5,000 shares of the Company's common stock, the shares and their value has been reflected in stockholder's equity as of Septem ber 30, 2010.

See Note 12 of these Condensed Consolidated Financial Statements included in this Quarterly Report for discussion of additional shares of common stock issued in connection with the acquisition of Professional Security Technologies LLC.

9. Segment Data

Selected information by business segment is presented in the following tables:

	For the nine months ended September 30, 2010	For the nine months ended September 30, 2009	For the three months ended September 30, 2010	For the three months ended September 30, 2009
Revenue				
Integration	$ 45,515,359	$ 40,463,589	$ 18,989,952	$ 11,576,861
Specialty	1,929,937	1,193,640	593,749	532,176
Inter-segment	(507,991)	(268,000)	(238,688)	—
Total revenue	$ 46,937,305	$ 41,389,229	$ 19,345,013	$ 12,109,037
Operating Profit				
Integration	$ 4,999,853	$ 2,585,029	$ 2,698,921	$ 266,890
Specialty	570,377	225,296	150,659	153,352
Corporate	(3,385,822)	(2,691,269)	(1,600,517)	(850,665)
Total operating profit	$ 2,184,408	$ 119,056	$ 1,249,063	$ (430,423)

Selected balance sheet information by business segment is presented in the following table as of:

	September 30, 2010	December 31, 2009
Total Assets:		
Integration	37,152,642	$ 27,309,364
Specialty	1,073,541	1,454,812
Corporate	3,538,660	3,928,119
Total assets	$ 41,764,843	$ 32,692,295

10. Contingent Liabilities

From time to time, the Company is subject to various claims with respect to matters arising out of the normal course of business. In management's opinion, none of these claims is likely to have a material effect on the Company's consolidated financial statements.

11. Related Party Transactions

Richard D. Rockwell, a member of the Board of Directors since November 2007, has been Owner and Chairman of Professional Security Technologies LLC, a full service security systems integrator since 1996. The Company had revenues from PST of $241,167 and $26,139 for the three months ended September 30, 2010 and 2009, respectively and had revenues from PST of $304,315 and $99,905 for the nine months ended September 30, 2010 and 2009, respectively. These revenues were principally related to the sale of equipment by the Company to PST. There were no outstanding accounts receivable from PST at September 30, 2010, but there was a balance of $39,192 as of December 31, 2009.

12. Acquisition of Professional Security Technologies LLC

On September 2, 2010, the Company purchased certain assets of Professional Security Technologies LLC ("PST") consisting principally of a customer list of existing and targeted potential PST customers ("PST Customers") and PST's assignment of its rights under an existing dealer agreement with a national equipment supplier pursuant to which the Company will be authorized to sell Supplier's products ("Supplier Products"). PST is a New Jersey limited liability company owned by the Company's Chairman of the Board of Directors. In addition, the Company agreed to hire certain PST employees. The Company accounted for this transaction in accordance with the provisions within Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 805 — *Business Combinations* . The total consideration expected to be paid to PST for

the assets was $1,062,811, as follows:

1. Cash of $80,811 paid at closing;
2. 150,000 shares of the Company's common stock, 75,000 of which will be delivered at closing. The remaining 75,000 shares will be held in escrow subject to delivery as described in point 4 below;
3. Payment of five (5%) percent of the net cash proceeds received by the Company, during the period commencing on July 1, 2010 and ending on December 31, 2012, in connection with (a) sales to PST customers (including sales of Supplier Products) and (b) sales of Supplier Products to the Company's other customers, and;
4. 75,000 shares of the Company's common stock when the aggregate revenue from the sales described above, during the period commencing on July 1, 2010 and ending on December 31, 2012, equal $8,000,000; provided, however, such shares will be released, prior to reaching the revenue target, in the event there is a change in control of the Company prior to December 31, 2012.

On the acquisition date, the fair value of the contingent consideration payable to PST was determined to be $682,344. At the end of each subsequent reporting period, the Company will record any changes in the fair value of the liability related to the contingent considerations as a charge to earnings.

The following table presents the allocation of the acquisition cost, to the assets acquired and liabilities assumed, based on their fair values at the date of acquisition:

Inventory	$	14,764
Property, plant and equipment		66,047
Customer relationships		130,000
Vendor agreement		60,000
Goodwill		792,000
Total assets acquired	$	1,062,811

Costs related to this acquisition were approximately $23,847 and are reflected in the Company's Condensed consolidated statements of operations.

13. Subsequent Event

On October 5, 2010, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Kratos Defense & Security Solutions, Inc., a Delaware corporation (" Parent "), and Hammer Acquisition Inc., a Delaware corporation and a wholly owned subsidiary of Parent (" Merger Sub "). The Merger Agreement provides that, upon the terms and subject to the conditions set forth in the Merger Agreement, Merger Sub will be merged with and into the Company, with the Company continuing as the surviving corporation and a wholly-owned subsidiary of Parent (the " Merger ").

At the effective time of the Merger (the "Effective Time"), by virtue of the Merger and without any action on the part of the holders of any Shares, each outstanding Share (other than Shares owned by Parent, Merger Sub, or the Company's stockholders, if any, who have perfected statutory dissenters' rights under Delaware law) will be converted into the right to receive $7.00 in cash, without interest. In addition, at the Effective Time all outstanding options to purchase the Company's common stock will be assumed by Parent and converted into options to purchase common stock of Parent (the " Assumed Options "). The number of shares of Parent common stock subject to each Assumed Option and the exercise price of each such option will be appropriately adjusted based on the exchange ratio, which shall be equal to 0.6552.

The completion of the Merger is subject to various customary conditions, including, among other things: (i) the adoption of the Merger Agreement by stockholders holding at least a majority of the outstanding common stock of the Company; (ii) subject to certain materiality exceptions, the accuracy of the representations and warranties made by each of Parent and the Company and the compliance by each of Parent and the Company with their respective obligations under the Merger Agreement and (iii) the absence of any pending or threatened legal proceedings challenging or seeking to restrain the consummation of the Merger. In addition, certain of the Company's shareholders and each member of the board of directors, who collectively held approximately 60% of the Company's issued and outstanding common stock as of October 5, 2010, have entered into voting agreeme nts whereby they have agreed to vote all shares of the Company's common stock held by them in favor of the Merger, subject to termination of such agreements if the Merger Agreement is terminated.

The Merger Agreement contains customary representations, warranties and covenants, including covenants obligating the Company to continue to conduct its business and the business of its subsidiaries in the ordinary course, hold a meeting of its stockholders for the purpose of considering the approval and adoption of the Merger Agreement and to cooperate on seeking regulatory approvals and providing access to information regarding the Company and its subsidiaries. The Merger Agreement also contains a "go-shop" provision and a "no-shop" provision.

This transaction is a disposal of a business and until all conditions of the merger have been met, including shareholder's vote, the business should continue to be shown in the results from operations of the Company and not as assets held for disposal.

On November 3, 2010, a putative shareholder class action lawsuit was filed in the Superior Court of New Jersey, Bergen County, against the Company, its directors and Kratos Defense & Security Solutions, Inc. purportedly on behalf of holders of the Company's common stock. *Atoll Advisors v. James E. Henry, et al.* , alleges that the individual defendants breached their fiduciary duties owed to the Company's stockholders in an attempt to sell the Company to Hammer Acquisition Inc., a wholly-owned subsidiary of Kratos, and Kratos at an unfair price and through an unfair and self serving process and by omitting material information in the preliminary proxy statement the Company filed with the Securities and Exchange Commission on October 25, 2010. The lawsuit further alleges that the Company and Kratos aided and abetted the Company's directors in their alleged breaches of fiduciary duty. The complaint seeks, among other relief, class certification, unspecified damages and plaintiff's costs, disbursements and reasonable attorneys' and experts' fees. The Company and the other defendants have not yet responded to the complaint. Based on the Company's review of the lawsuit, it believes that the claims are without merit and it intends to vigorously defend against them. Regardless of the merits or eventual outcome, the lawsuit may cause a diversion of the Company's management's time and attention and the expenditure of legal fees and expenses.

UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS

On December 15, 2010, Kratos Defense & Security Solutions, Inc. ("Kratos" or the "Company") completed its acquisition of Henry Bros. Electronics, Inc. ("HBE") pursuant to an Agreement and Plan of Merger, dated October 5, 2010 and as amended November 13, 2010. As a result of the merger, HBE became a wholly-owned subsidiary of the Company. The acquisition was accounted for under the acquisition method of accounting. The purchase price was $56.6 million, $54.9 million was paid in cash and $1.7 million reflects the fair value of the replacement options issued to HBE option holders.

For purposes of these unaudited pro forma condensed combined financial statements, the total purchase price was allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based upon the historical unaudited HBE September 30, 2010 balance sheet, included herein, and the Company's preliminary estimate of certain fair values. The excess purchase price over the fair value of the net assets acquired was recorded as goodwill. The final purchase price allocation may differ from the pro forma amounts reflected herein. The allocation of the purchase price will be adjusted in accordance with the acquisition method of accounting, to the extent that actual amounts differ from the amounts included in the pro forma financial information.

The unaudited pro forma condensed combined balance sheet combines the unaudited condensed consolidated balance sheet of the Company as of September 26, 2010 and the unaudited condensed consolidated balance sheet of HBE as of September 30, 2010, and gives effect to the acquisition as if it had been completed on September 26, 2010, including any adjustments to the fair value of assets and liabilities acquired, in accordance with the acquisition method of accounting.

The unaudited pro forma condensed combined statement of income for the nine months ended September 26, 2010, combines the historical results of the Company and the historical results of HBE and the Company's previous acquisition of Gichner Holdings, Inc. ("Gichner") on May 19, 2010, and gives effect to both the acquisitions as if they had occurred on December 29, 2008.

The unaudited pro forma condensed combined statement of income for the year ended December 27, 2009, combines the historical results of the Company and the historical results of HBE and the Company's previous acquisition of Gichner and gives effect to both acquisitions as if they had occurred on December 29, 2008.

The unaudited pro forma condensed combined financial statements presented are based on the assumptions and adjustments described in the accompanying notes.

The unaudited pro forma condensed combined financial statements are presented for illustrative purposes only and do not purport to represent what the financial position or results of operations of the Company would actually have been if the acquisitions occurred as of the dates indicated or what such financial position or results will be for any future periods. The pro forma information gives effect only to the adjustments set forth in the accompanying notes and does not reflect any anticipated synergies which may be realized by the Company. The unaudited pro forma condensed combined financial statements are based upon the respective historical and pro forma financial information of the Company, HBE and Gichner, and are derived from the following sources:

- the accompanying notes to unaudited pro forma condensed combined financial statements;
- the separate historical audited consolidated financial statements of the Company as of and for the year ended December 27, 2009, included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 11, 2010;
- the separate historical unaudited condensed consolidated financial statements of the Company as of and for the nine months ended September 26, 2010, included in the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 5, 2010;
- the separate historical audited consolidated financial statements of HBE as of and for the years ended December 31, 2009, 2008 and 2007, included in Exhibit 99.1 of this Current Report on Form 8-K/A;
- the separate historical unaudited condensed consolidated financial statements of HBE as of September 30, 2010 and for the nine months ended September 30, 2010 and 2009, included in Exhibit 99.2 of this Current Report on Form 8-K/A;

- the separate historical audited consolidated financial statements of Gichner as of December 31, 2009 and for the year then ended and related notes to the financial statements, which have not been included in this Current Report on Form 8-K/A but were filed in the Company's Current Report on Form 8-K filed on May 25, 2010; and
- the separate historical unaudited condensed statement of operations of Gichner for the three months ended March 31, 2010 which have not been included in this Current Report on Form 8-K/A but were filed in the Company's Current Report on Form 8-K filed on May 25, 2010.

The historical consolidated financial information has been adjusted in the unaudited pro forma condensed combined financial statements to give effect to pro forma events that are (1) directly attributable to the acquisitions, (2) factually supportable, and (3) with respect to the statement of operations, expected to have a continuing impact on the combined results. The pro forma information does not reflect revenue opportunities and cost savings that we expect to realize after the acquisitions. The pro forma financial statements also do not reflect expenses related to integration activity or exit costs that may be incurred by Kratos or Gichner in connection with the acquisitions.

Based upon the Company's preliminary review of HBE's summary of significant accounting policies disclosed in its audited financial statements, incorporated herein by reference, the nature and amount of any adjustments to the historical financial statements of HBE to conform HBE's accounting policies to those of the Company's are not expected to be significant.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
Unaudited Pro Forma Condensed Combined Balance Sheet
(in millions, except par value and number of shares)

	Kratos Historical September 26, 2010	HBE Historical September 30, 2010	Preliminary Pro Forma Adjustments*	Pro Forma Combined
Assets				
Current assets:				
Cash and cash equivalents	$ 51.3	$ 2.0	$ (33.0)(a)	$ 20.3
Restricted cash	8.7	—	—	8.7
Accounts receivable, net	92.6	28.0	—	120.6
Inventory	25.7	1.8	—	27.5
Income taxes receivable	2.3	0.3	—	2.6
Prepaid expenses	10.1	0.2	—	10.3
Other current assets	4.9	1.4	(0.8)(b)	5.5
Total current assets	195.6	33.7	(33.8)	195.5
Property and equipment, net	24.2	2.0	—	26.2
Goodwill	187.2	4.8	30.7(b)(c)	222.7
Intangibles, net	70.0	0.9	17.7(d)	88.6
Other assets	7.9	0.3	(1.3)(b)	6.9
Total assets	$ 484.9	$ 41.7	$ 13.3	$ 539.9
Liabilities and Stockholders' Equity				
Current liabilities:				
Accounts payable	$ 30.9	$ 8.7	$ —	$ 39.6
Accrued expenses	18.9	2.9	—	21.8
Accrued compensation	22.2	1.7	—	23.9
Billings in excess of costs and earnings on uncompleted contracts	18.1	2.8	—	20.9
Current portion of long-term debt	—	—	—	—
Other current liabilities	13.0	1.8	7.7(b)	22.5
Total current liabilities	103.1	17.9	7.7	128.7
Long-term debt, net of current portion	225.0	5.1	—	230.1
Other long-term liabilities	14.5	0.7	—	15.2
Total liabilities	342.6	23.7	7.7	374.0
Commitments and contingencies				
Stockholders' equity:				
Preferred stock, 5,000,000 shares authorized Series B Convertible Preferred Stock, $.001 par value, 10,000 shares outstanding at December 27, 2009 and September 26, 2010 (liquidation preference $5.0 million at September 26, 2009)	—	—	—	—
Common stock, $.001 par value, 195,000,000 shares authorized; 15,784,591 and 16,025,661 shares issued and outstanding at December 27, 2009 and September 26, 2010, respectively	—	—	—	—
Additional paid-in capital	526.3	19.4	7.0(e)	552.7
Retained earnings and accumulated deficit	(384.0)	(1.4)	(1.4)(f)	(386.8)
Total stockholders' equity	142.3	18.0	5.6	165.9
Total liabilities and stockholders' equity	$ 484.9	$ 41.7	$ 13.3	$ 539.9

* See Note 6 for an explanation of the preliminary pro forma adjustments.

See accompanying notes to unaudited pro forma condensed combined financial statements

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
Unaudited Pro Forma Condensed Combined Statement of Operations
(in millions, except per share data)

	Kratos Historical Nine Months Ended September 26, 2010	Gichner Historical Three Months Ended March 31, 2010	HBE Historical Nine Months Ended September 30, 2010	Preliminary Pro Forma Adjustments*	Pro Forma Combined
Service revenues	$ 211.5	$ —	$ 46.9	$ —	$ 258.4
Product sales	76.2	49.9	—	—	126.1
Total revenues	287.7	49.9	46.9	—	384.5
Cost of service revenue	162.0				162.0

Cost of product sales	62.0	41.1	33.5	—	136.6
Total costs	224.0	41.1	33.5	—	298.6
Gross profit	63.7	8.8	13.4	—	85.9
Selling, general and administrative expenses	45.5	3.7	10.7	1.3(a)(b)	61.2
Recovery of legal fees in connection with litigation	(1.4)	—	—	—	(1.4)
Merger and acquisition expenses	1.5	—	0.5	—	2.0
Research and development expenses	1.6	—	—	—	1.6
Operating loss from continuing operations	16.5	5.1	2.2	(1.3)	22.5
Other expense:					
Interest expense, net	(15.8)	(0.4)	(0.1)	(2.9)(c)	(19.2)
Other income, net	0.8	(0.1)	0.0		0.7
Total other expense, net	(15.0)	(0.5)	(0.1)	(2.9)	(18.5)
Income (loss) from continuing operations before income taxes	1.5	4.6	2.1	(4.2)	4.0
Provision for income taxes from continuing operations	(12.5)	1.6	0.9	(1.7)(d)	(11.7)
Income (loss) from continuing operations	$ 14.0	$ 3.0	$ 1.2	$ (2.5)	$ 15.7
Basic loss per common share:					
Loss from continuing operations	$ 0.87				$ 0.85
Diluted loss per common share:					
Loss from continuing operations	$ 0.85				$ 0.96
Weighted average common shares outstanding:					
Basic	16.0		2.5(e)		18.5
Diluted	16.4		2.7		16.4

* See Note 7 for an explanation of the preliminary pro forma adjustments.

See accompanying notes to unaudited pro forma condensed combined financial statements

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
Unaudited Pro Forma Condensed Combined Statement of Operations
(in millions, except per share data)

	Kratos Historical Twelve Months Ended December 27, 2009	Gichner Historical Twelve Months Ended December 31, 2009	HBE Historical Twelve Months Ended December 31, 2009	Preliminary Pro Forma Adjustments*	Pro Forma Combined
Revenues	$ 334.5	$ 147.1	$ 55.1	$ —	$ 536.7
Cost of revenues	265.2	122.4	40.8	—	428.4
Gross profit	69.3	24.7	14.3	—	108.3
Selling, general and administrative expenses	52.8	12.6	15.0	6.3(a)(b)	86.7
Research and development expenses	1.8	—	—	—	1.8
Recovery of unauthorized issuance of stock options, stock option investigation and related fees, and litigation settlement	(0.2)	—	—	—	(0.2)
Impairment of goodwill	41.3	—	—	—	41.3
Impairments and adjustments to the liability of unused office space	0.6	—	—	—	0.6
Operating loss from continuing operations	(27.0)	12.1	(0.7)	(6.3)	(21.9)
Other expense:					
Interest expense, net	(10.4)	(1.5)	(0.3)	(13.5)(c)	(25.7)
Other income, net	0.1	—	0.1	—	0.2
Total other expense, net	(10.3)	(1.5)	(0.2)	(13.5)	(25.5)
Income (loss) from continuing operations before income taxes	(37.3)	10.6	(0.9)	(19.8)	(47.4)
Provision for income taxes from continuing operations	1.0	5.1	(0.1)	(4.3)(d)	1.7
Income (loss) from continuing operations	$ (38.3)	$ 5.5	$ (0.8)	$ (15.5)	$ (49.1)
Basic loss per common share:					
Loss from continuing operations	$ (2.76)				$ (2.99)
Diluted loss per common share:					
Loss from continuing operations	$ (2.76)				$ (2.99)
Weighted average common shares outstanding:					
Basic	13.9		2.5(e)		16.4
Diluted	13.9		2.5		16.4

* See Note 7 for an explanation of the preliminary pro forma adjustments.

See accompanying notes to unaudited pro forma condensed combined financial statements

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Kratos Defense & Security Solutions, Inc.
Notes to Unaudited Pro Forma Condensed Combined Financial Statements

1. Description of Transaction

On December 15, 2010, Kratos Defense & Security Solutions, Inc. ("Kratos" or "Company") completed its acquisition of Henry Bros. Electronics, Inc. ("HBE") pursuant to an Agreement and Plan of Merger, dated October 5, 2010 and as amended November 13, 2010. As a result of the merger, HBE became a wholly-owned subsidiary of the Company. The purchase price was $56.6 million, $54.9 million was paid in cash and $1.7 million reflects the fair value of the replacement options issued to HBE option holders.

HBE is a provider of homeland security solutions, products, and system integration services, including the design, engineering and operation of command and control systems for the protection of strategic assets and critical infrastructure in the United States. HBE also has particular expertise in the design, engineering, deployment and operation of specialized surveillance, thermal imaging, analytics, radar, and biometrics technology based security systems.

On October 12, 2010, Kratos sold approximately 2.5 million shares of its common stock at a purchase price of $10.20 per share in an underwritten public offering. The Company received gross proceeds of approximately $25.8 million. After deducting underwriting fees and other offering expenses, the Company received approximately $24.7 million in net proceeds. The Company used the net proceeds from this transaction to fund the purchase price for the acquisition of HBE.

2. Basis of Presentation

The unaudited pro forma condensed combined financial statements are based on the historical financial statements of Kratos, HBE and Gichner and are prepared and presented pursuant to the regulations of the SEC regarding pro forma financial information. Certain reclassifications were made to the HBE consolidated financial statements to conform them to Kratos's presentation.

The Company acquired Gichner on May 19, 2010; the assets acquired and liabilities assumed with the Gichner transaction are included in the Company's column of the unaudited pro forma condensed combined balance sheet presented as of September 26, 2010; and its results of operations are included in the Company's column of the unaudited pro forma condensed combined statement of operations presented for the nine months ended September 26, 2010 from the date of acquisition.

The 2009 unaudited pro forma condensed combined financial statements include HBE's and Gichner's audited consolidated statement of operations data for the fiscal year ended December 31, 2009 and the Kratos audited consolidated statement of operations data for the fiscal year ended December 27, 2009.

The 2010 unaudited pro forma condensed combined financial statements include HBE's unaudited consolidated balance sheet data as of September 30, 2010, HBE's unaudited consolidated statement of operations data for the nine months ended September 30, 2010, Gichner's unaudited consolidated statement of operations data for the three months ended March 31, 2010, the Kratos unaudited consolidated balance sheet data as of September 26, 2010 and the Kratos unaudited consolidated statement of operations data for the nine months ended September 26, 2010.

The pro forma adjustments include the application of the acquisition method of accounting under Financial Accounting Standards Board Accounting Standards Codification (ASC) Topic 805 Business Combinations (ASC Topic 805). ASC Topic 805 requires, among other things, that identifiable assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date, which is presumed to be the closing date of the Acquisition.

Under ASC Topic 820 Fair Value Measurements and Disclosures (ASC Topic 820), "fair value" is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820 specifies a hierarchy of valuation techniques based on the nature of the inputs used to develop the fair value measures. This is an exit price concept for the valuation of the asset or liability. In addition, market participants are assumed to be unrelated buyers and sellers in the principal or the most advantageous market for the asset or liability. Fair value measurements for an asset assume the highest and best use by these market participants. Many of these fair value measurements can be highly subjective and it is also possible that other professionals, applying reasonable judgment to the same facts and circumstances, could develop and support a range of alternative estimated amounts.

The unaudited pro forma combined balance sheet reflects the estimated HBE acquisition-related transaction costs incurred by Kratos of $1.6 million and assumed to be paid in connection with the closing of the acquisition.

The historical consolidated financial information has been adjusted in the unaudited pro forma condensed combined financial statements to give effect to pro forma events that are (1) directly attributable to the acquisitions, (2) factually supportable, and (3) with respect to the statement of operations, expected to have a continuing impact on the combined results. The pro forma financial statements do not reflect revenue opportunities, synergies or cost savings that the Company expects to realize after the acquisitions. No assurance can be given with respect to the estimated revenue opportunities and operating cost savings that are expected to be realized as a result of the acquisitions. The pro forma financial statements also do not reflect non-recurring charges related to integration activities or exit costs that may be incurred by Kratos, Gichner or HBE in connection with t he acquisitions. There were no material transactions between Kratos, HBE and Gichner during the periods presented in the unaudited pro forma combined financial information that would need to be eliminated.

3. Accounting Policies

Based upon the Company's preliminary review of HBE's summary of significant accounting policies disclosed in its audited financial statements, incorporated herein by reference, the nature and amount of any adjustments to the historical financial statements of HBE to conform HBE's accounting policies to those of the Company's are not expected to be significant.

4. Consideration Transferred and Purchase Price Allocation

The initial consideration transferred and the aggregate purchase price to be allocated is presented in the table below (in millions).

Cash payable as merger consideration	$	54.9
Fair value of Kratos replacement options issued to HBE option holders		1.7
Estimate of acquisition consideration(a)	$	56.6

(a) Kratos funded the cash payment with cash on hand and the proceeds of the issuance of shares of its common stock on October 12, 2010, as described in Note 1 above.

5. Estimate of Assets to be Acquired and Liabilities to be Assumed

The following is a discussion of the adjustments made in connection with the preparation of the unaudited pro forma condensed combined financial statements. Each of these adjustments represents preliminary estimates of the fair values of HBE's assets and liabilities and periodic amortization of such adjustments to the extent applicable. Actual adjustments will be made when the final fair value of HBE's assets and liabilities is determined. Accordingly, the actual adjustments to HBE's assets and liabilities and the related amortization of such adjustments may differ materially from the estimates reflected in the unaudited pro forma condensed combined financial statements.

The following is the preliminary estimate of the assets acquired and the liabilities assumed by Kratos reconciled to the consideration transferred (in millions):

Book value of HBE net assets acquired	$	12.3
Acquisition accounting adjustment for deferred taxes		(9.8)
Identifiable intangible assets		18.6
Goodwill		35.5
Purchase price allocated	$	56.6

Goodwill: Goodwill is calculated as the excess of the acquisition date fair value of the consideration transferred over the values assigned to the identifiable assets acquired and liabilities assumed. Goodwill is not amortized but rather is subject to an annual impairment test.

Intangible assets: A preliminary estimate of the fair value of the acquired identifiable intangible assets, which are subject to amortization, using the income approach has been made. Further analysis must be performed to value those assets at fair value and allocate purchase price to those assets. As such, the value of intangible assets may differ significantly from the amount reflected on the unaudited pro forma condensed combined financial information. Amortization recorded in the statement of operations may also differ based on the valuation of intangible assets. The following table sets forth the components of these intangible assets and their estimated useful lives (dollars in millions):

		Fair Value	Estimated Useful Life
Existing Customer Contracts	$	2.8	3 years
Trade Names		15.8	Indefinite
	$	18.6	

6. Adjustments to Unaudited Pro Forma Condensed Combined Balance Sheet:

(a) The sources and uses of funds relating to the acquisition are as follows (in millions):

Sources:		
Proceeds from issuance of common stock on October 12, 2010 (See Note 1)	$	24.7
Cash paid to shareholders of HBE		(54.9)
Payment of transaction costs		(2.8)
Net adjustment of cash and cash equivalents	$	(33.0)

(b) Reflects adjustments to deferred taxes and goodwill as a result of the impact of indefinite lived intangibles acquired.

(c) Reflects adjustments for goodwill (See Note 5):

Eliminate HBE historical goodwill	$	(4.8)
Record transaction goodwill		35.5
Goodwill adjustment	$	30.7

(d) Reflects adjustments to intangibles:

Eliminate HBE historical intangibles	$	(0.9)
Record estimated transaction intangibles		18.6
Intangibles adjustment	$	17.7

(e) Reflects elimination of HBE additional paid-in capital, value of issuance of shares of common stock in connection with the Acquisition of $24.7 million and $1.7 million related to the fair value of options acquired.

(f) Reflects adjustments to retained earnings:

Eliminate HBE retained earnings	$	1.4
Impact of transaction closing costs expensed at time of closing for HBE		(1.4)
Impact of transaction closing costs expensed at time of closing for Kratos		(1.4)
Retained earnings adjustment	$	(1.4)

7. Adjustments to Unaudited Pro Forma Condensed Combined Statement of Operations:

(a) Net decrease in amortization expense to reflect the adjustment for intangibles not acquired in the transactions, net of the amortization expense of identifiable intangible assets arising from the purchase price allocations. Identifiable intangible assets are being amortized using the straight-line method and their weighted average useful lives.

		Nine Months Ended September 26, 2010		Twelve Months Ended December 27, 2009
HBE	$	0.6	$	0.7
Gichner		0.8		5.8
	$	1.4	$	6.5

(b) Reflects a net reduction of stock compensation expense of $0.1 million for the nine months ended September 26, 2010 and $0.2 million for the year ended December 27, 2009 as a result of the elimination of stock compensation expense related to options exercised at closing offset by the stock compensation expense for options assumed.

(c) Interest expense adjustments (in millions):

		Nine Months Ended September 26, 2010		Year-ended December 27, 2009
Estimated interest on new debt	$	18.1	$	24.2
Eliminate interest cost on existing Gichner debt		(0.4)		(1.5)
Eliminate interest cost on existing Kratos debt		(14.8)		(9.2)
Net change in interest expense	$	2.9	$	13.5

To finance the Gichner acquisition the Company closed a private offering of $225 million in aggregate principal amount of 10% Senior Secured Notes due 2017 and entered into a 4-year, $25.0 million New Revolving Credit Facility, which is secured by a first priority lien on the combined entity's accounts receivables and inventory. The interest expense is based on the interest cost of the debt facilities that were the result of the Gichner acquisition.

(d) Reflects the income tax effects of pro forma adjustments and utilization of Kratos net operating losses and tax attributes to offset tax expense that HBE and Gichner would otherwise incur on a stand-alone basis.

(e) Reflects the issuance of 2.5 million shares on October 12, 2010 and dilutive effect of options assumed for the acquisition of HBE.